

COMMONWEALTH OF KENTUCKY
DEPARTMENT OF FINANCIAL INSTITUTIONS
Complaint No. 03-AH-018

THE DEPARTMENT OF FINANCIAL INSTITUTIONS
OF THE COMMONWEALTH OF KENTUCKY

PETITIONER

vs.

Rise, Inc.
8143 New LaGrange Road
Louisville, Kentucky 40222-5466

Gregory Smith, Registered
Principal and Owner
Rise, Inc.
8143 New LaGrange Road
Louisville, KY 40222-5466

RESPONDENTS

FINAL ORDER

PROCEDURAL BACKGROUND

1. An administrative Complaint was filed in this matter pursuant to 808 KAR 10:225 on November 6, 2003. Said Complaint was served upon Respondents by certified mail at the addresses above. The Green Card Receipt indicates that the Complaint was received November 14, 2003. As of December 11, 2003, twenty-seven (27) days have elapsed and no Answer has been filed in the matter. Pursuant to the requirements of 808 KAR 10:225, an Answer must be filed within twenty (20) days of service of the Complaint.

2. Pursuant to 808 KAR 10:225, the failure to file an Answer to an Administrative Complaint authorizes the Commissioner to enter a Final Order in the matter. Since there is no Answer filed in this matter, the entire record consists of the

information obtained by the Department in its investigation and the allegations in the Administrative Complaint filed in this matter.

Findings of Fact

Main—Securities Issues

3. The Kentucky Department of Financial Institutions made all reasonable attempts possible to give notice to respondent of these proceedings. The Department's efforts to give notice were reasonable. The respondent has Notice of these proceedings and has affirmatively chosen not to appear and present a defense.

4. Pursuant to KRS 292.500(1) and 292.500(3), the Commissioner ("Commissioner") of the Department of Financial Institutions, ("Department") is charged with the administration and enforcement of KRS Chapter 292, the Securities Act of Kentucky, ("Act").

5. Pursuant to KRS 292.460, the Commissioner has the power to make such public or private investigations within or outside of the Commonwealth of Kentucky as she deems necessary to determine whether any registration should be granted, denied or revoked or whether any person has violated or is about to violate any provision of the Act or the regulations promulgated and Orders entered pursuant to the Act.

6. Pursuant to KRS 292.460, the Commissioner has caused an investigation to be made by the staff of the Department to determine whether the Respondent(s) or any one or several of them are about to violate or have violated the Act.

Respondents

- a) Respondent, Rise, Inc. is a Registered Broker/Dealer located at 8143 New LaGrange Rd.; Louisville, KY 40222. Respondent, Gregory Smith, Registered

General Securities Principal owns Respondent, Rise, Inc. Respondent, Smith, is a "Control Person," as that term is used in the securities laws. Smith is responsible for the supervision of Bret O'Brien, a registered representative employed by Rise, Inc.

FACTS

- b) The Division of Securities ("Division") of the Department has received complaints from two clients of Rise, Inc., namely one [REDACTED] and one [REDACTED].
- c) [REDACTED] opened a new account in her name only on February 11, 1997. This new account had Income and Long Term Growth as her investment objectives. [REDACTED] was born May 24, 1928 and she indicated her income was \$20,000 and her net worth, excluding residence, was \$100,000. Mr. O'Brien was the Representative on the account.
- d) Mr. O'Brien put [REDACTED] in a margin account that she did not understand and purchased unsuitable securities without her prior knowledge in that account. In or about September 1997, [REDACTED] began to take a disbursement of \$250/month out of the account. At this time, [REDACTED] investments were in Growth and Income Mutual Funds. On or about November 11, 1998, [REDACTED] told Mr. O'Brien she needed to take additional funds out of the account. Mr. O'Brien had her fill out a revised New Account Agreement that opened a margin account and changed her objectives to Conservative Appreciation/Long Term Growth and Aggressive Appreciation.

- e) O'Brien told the department he had discussed this with [REDACTED] and they had decided that with what the market was doing at the time it made more sense for her to borrow the money on the account instead of taking it out and losing the opportunity for future growth. [REDACTED] did not understand what Mr. O'Brien was suggesting. [REDACTED] wrote several checks on the account and increased her monthly distribution to \$350. [REDACTED] did not understand that at this point most of that money was from her margin account, so she was running up debt. The total amount that was withdrawn over the life of the account was around \$22,857.23. Her initial deposit into the account from the transfer from the joint account was \$36,231.75.
- f) O'Brien began to purchase small cap stock that was questionable as to its suitability for [REDACTED]. [REDACTED] did not approve these trades. [REDACTED] held several of these small company stocks over the time the account was open, but the bulk of the holdings were in GlobalnetFinancial.com (GLBN). Analysts were touting this company, but it had always operated at a loss. Mr. O'Brien purchased some of these shares with cash and some on margin. For much of the time the account was open, the percentage of these stocks held in the account was in the 9—15% range, but near the end it was much higher and eventually 100% after margin calls depleted the balance of the mutual funds that [REDACTED] held. According to her March, 2000 account statement, [REDACTED] had a Long Market value of \$142,748.27, a Net Market Value of \$60,023.48, and a Margin Balance of \$82,724.79. GLBN made up \$78,925.00 or 58% of that total. Soon after, the market began to drop and margin calls began to be

sent. [REDACTED] spoke with Mr. O'Brien about the margin call telegrams she was receiving, but she was told he would take care of it. She did not understand that Mr. O'Brien was selling off her mutual funds to cover the calls. These calls eventually depleted her relatively conservative mutual fund investments to zero and left her with only GLBN, which was continuing to fall as well. Eventually, the margin calls depleted the amount remaining in the account and caused the account to be closed.

- g) [REDACTED] has complaints similar to [REDACTED], including being placed in a margin account she did not understand as well as unauthorized trading. She opened the account on August 2, 1999, with the objectives of Conservative Appreciation/Long Term Growth and Aggressive Appreciation. Mr. O'Brien was the representative on her account.
- h) [REDACTED] income was indicated as below \$75,000 and her Net Worth was \$250,000—\$1,000,000. She is a teacher for [REDACTED] County, Kentucky and was investing the proceeds from the sale of her house after her husband passed away. According to [REDACTED], her annual income at the time was approximately \$40,000, and the approximate \$120,000 she eventually invested with Rise, Inc. was her total savings. She was in her fifties at the time and wanted the invested money to provide supplemental income upon her retirement. She had no previous investment experience.
- i) [REDACTED] was invested in small capitalization technology stocks. Her main holding over the life of the account was GLBN and most of the purchases were made on Margin. She deposited a total of \$27,500 in the account and withdrew

\$4000 between February and April of 2000. [REDACTED] also was unaware of what a Margin account was and she didn't understand that she was borrowing money to buy the stocks. In August of 2000, the Margin calls began to hit the account due to Globalnet's falling price and the account closed in January of 2001 after [REDACTED] sold the rest of her Globalnet holdings for \$305.74 and liquidated the account.

- j) [REDACTED] had a net loss of around \$13,374.52 and [REDACTED] had a net loss of around \$23,194.26.
- k) O'Brien placed both of these clients in unsuitable high-risk margin accounts designed for sophisticated investors. In addition, he recommended and executed unsuitable trades in high-risk technology stocks, some without prior approval from the clients. The firm's owner and O'Brien's supervisor, Gregory Smith, acknowledges he approved O'Brien's actions and does not find a problem with the investment strategy or trades that O'Brien recommended. As a result, both clients lost money they could not afford to lose.
- l) It is in the public interest that the Commissioner take strong, decisive, and swift action against the Respondents.

THE VIOLATIONS OF THE ACT

COUNT I.

7. Respondent, Rise, Inc. and Respondent, Gregory Smith, Registered General Securities Principal and Owner, a "Control Person," is liable as such, are each in violation of 808 KAR 10:030 (Suitability) for each sale (the Small Capitalization

Technology Stocks) above to [REDACTED] and [REDACTED] and for those purchases (buys) listed in the appendix as unsuitable.

COUNT II.

8. By placing [REDACTED] and [REDACTED] in margin accounts, Respondents Rise, Inc. and Respondent, Gregory Smith, Registered Principal and Owner, a "Control Person," is liable as such, are each in violation of 808 KAR 10:040, Section 1, (5)(a) Dishonest and unethical practices and KRS 292.330(13)(a)7. * Although a margin account represents a perfectly acceptable practice in the brokerage industry, it must only be used for customers who can appreciate its potential pitfalls as well as its benefits. Margin accounts are not for everyone. This is only a violation because these customers never understood and never had it explained to them that they were borrowing to buy stocks. For this kind of customer, a margin account should never be established because this kind of customer is not capable of handling the pitfalls of a margin account and will therefore hurt themselves by having a margin account. Each incident of setting up a margin account in *this particular case with its unique circumstances* is a dishonest and unethical practice.

COUNT III.

9. By making trades that were unauthorized by [REDACTED] and [REDACTED], Respondents violated KRS 292.330(13)(a)7., and 808 KAR 10:040, Section 1, (3)(a). Each unauthorized trade is a violation (or count) of these sections of the statute and the regulation.

THE PUBLIC INTEREST

10. It is in the public interest that the Department take action against the Respondents.

11. There is no indication in information in the investigation to date that the Respondents will cease their conduct or cease to violate the Act unless some action is taken to prevent violations of the Act. In fact the information in the investigation demonstrates that the Respondents will continue to violate the Act unless some action is taken. The Commissioner should find, based on the information obtained pursuant to the Department's investigation, that actions alleged to have been done by the Respondents acting alone and/or through agents constitute a present and continuing harm to the investing public of Kentucky.

12. The failure to take remedial steps to enforce the Act in this matter harms other registered persons and/or entities that adhere to the provisions of the Act and the applicable regulations and orders of the Commissioner. The failure to take remedial steps to enforce the Act in this matter would encourage others to ignore the provisions of the Act and the regulations and orders of the Commissioner promulgated pursuant thereto and this would take the protections afforded the Kentucky investing public by the Act away from the public.

13. In light of the facts alleged herein, it is in the public interest to take action against the entities, issuers and agents named herein to cause them to cease and desist violating the Act, and to take other remedial measures necessary to make investors whole and to prevent such violations of the Act in the future.

14. The Department and the Commissioner have jurisdiction in this matter.

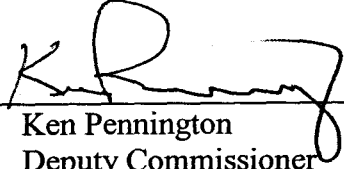
15. Venue is proper in Franklin County, Kentucky.

ORDER

IT IS HEREBY ORDERED AS FOLLOWS:

- a.) All of the Respondents herein **SHALL** permanently Cease and Desist violating the Securities Act of Kentucky.
- b.) The registration of the Respondent firm pursuant to KRS 292.330 is hereby **SUSPENDED** for a period of thirty (30) days commencing on the date of receipt of this Order and ending on the thirtieth day thereafter.
- c.) A fine of ***Fifty thousand dollars*** (\$50,000) is hereby imposed jointly and severally on all of the Respondents named herein. Said fine shall be collected from as few or as many respondents as convenient to the Commonwealth of Kentucky. Respondents shall have the right to seek contribution from other respondents to the extent one or several of them have paid part or the entire fine imposed herein. Such seeking of contribution shall not involve the Department or the Commonwealth of Kentucky.
- d.) This is a Final and Appealable Order.

Entered and signed this 7th day of January, 2004.



Ken Pennington
Deputy Commissioner
Department of Financial
Institutions
Commonwealth of Kentucky
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